



“SHOW ME THE MONEY”

 **Bill Fournier**

The recent article entitled, “How to Make Incentive and Award Fees Work,” makes a case for program success using multiple incentives and subjective award fees, was originally published in the *Defense Acquisition Review Journal (ARJ)*, Issue 48, July 2008, Vol. 16, No. 2. The article used a definition of program success as the perception from the program managers and contracting officers themselves. I question the possible unintended positive biases and inability to measure real vs. perceived integrated program success.

“Show me the money”—a famous quote from the movie *Jerry Maguire*—best expresses how following the money can improve program management contract financial incentives. This can be applied consistently with a CAIV (Cost as an Independent Variable) approach in which the government fixes a threshold for schedule, performance, and risk variables, and offers financial incentives based on the short-term and long-term expected costs.

Some incentives’ approaches encourage the developer’s activities, which although appearing positive, are actually misleading. These incentives’ approaches may allow the developer to maximize the collecting of incentives by trading off other areas such as increasing the schedules’ risks or reducing the system’s performance. The developer can decide to ignore the current contracts’ incentives intentionally to reduce competition and thus collect larger expected future incentives. Some incentives’ approaches have three major shortcomings: not considering the future contracts, being complicated, or being subjective.

Future contracts' impacts need consideration in regard to financial incentives or contracting strategies. A \$100,000 competition incentive on the System Design and Development (SDD) phase contract will be ineffective when earning it would increase the developer's competition on the follow-on billion-dollar production contract. The government should consider a few likely developer actions to reduce competition on future contracts (example: a late and/or poor quality Technical Data Package).

A better method to deal with future contracts' impacts is to align the contracting strategy such that the government and contractor are both incentivized for short- and long-term program success. This approach needs to consider the best way to leverage long-term competition in order to align the developers' financial incentives at the right points in the life cycle. In the above example, some programs' contracting strategies should have the competitive SDD contract with a priced production option.

The second shortcoming is having complicated incentive risks such as cost and performance incentives. One situation is when minimum weight and minimum cost incentives on the same contract are usually traded off in design. The problem is these incentives work against each other. A design to minimize cost will not be the lightest. The lightest design will be more costly in efforts to reduce weight by using more expensive materials. Financial incentives can encourage the trade-off of schedule and other performance parameters in unintended ways. This approach is tempting for the value added of pushing the performance from the threshold to the objective value, but tends to fail because of an imperfect knowledge of true design trade-offs. A better CAIV-type approach is to fix threshold values for everything except cost. The cost incentive should be based on an expected net present value life cycle cost.

The third shortcoming is subjectivity. Subjective items can be ineffective for two reasons: the difficulty in measuring the improvement of the integrated program success and the increased burden of the resources to administer the contract. Subjective incentives do provide the program more flexibility, but the continual shifting of contract priorities for the program can be damaging. One analogy here is like pushing a three-dimensional balloon; one needs to be wary of making progress in one area (the X axis) but losing progress in another area (the Y or Z axis).

Basically, I am worried about my balloon analogy: that gains in incentive areas will be losses in other areas. When feasible, I feel a better approach is to strive to be objective, to be simple, and to consider the whole program life cycle. Good financial incentives can enhance the likelihood of real integrated program success.

William "Bill" Fournier

E-mail address: william.r.fournier@saic.com